

Pages 1 - 44

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

Before The Honorable Richard Seeborg, Judge

SHASTA STRATEGIC INVESTMENT )		
FUND, LLC; and PRESIDIO GROWTH )		
LLC (Tax Matters Partners), et )		
al., )		
	) NO. C 04-04264 RS	
Petitioners, )		
	) AND RELATED CASES:	
VS. ) C 04-04309 RS, 04-04398 RS,		
	) 04-04964 RS, 05-01123 RS,	
	) 05-01996 RS, 05-02835 RS,	
	) and 05-03887 RS	
UNITED STATES OF AMERICA, )		
	)	
Respondent. )		
	)	

San Francisco, California  
Thursday, June 20, 2013

TRANSCRIPT OF PROCEEDINGS

APPEARANCES:

For Petitioners:

LATHAM & WATKINS  
505 Montgomery Street - Suite 1900  
San Francisco, California 94111  
BY: **STEVEN M. BAUER, ATTORNEY AT LAW**

For Respondent:

U.S. DEPARTMENT OF JUSTICE  
Tax Division  
555 Fourth St., N.W. - Room 7217  
Washington, D.C. 20001  
BY: **JAMES E. WEAVER, TRIAL ATTORNEY**  
**ADAM D. STRAIT, TRIAL ATTORNEY**  
**ADAIR F. BOROUGH, TRIAL ATTORNEY**

**(APPEARANCES CONTINUED ON FOLLOWING PAGE)**

REPORTED BY: Jo Ann Bryce, CSR No. 3321, RMR, CRR, FCRR  
Official Reporter

1 **APPEARANCES:** (CONTINUED)

2 For Intervenors J. Paul Reddam and Clarence Ventures LLC:

3 LAW OFFICE OF DAVID W. WIECHERT

4 115 Avenida Miramar

5 San Clemente, California 92672

6 **BY: DAVID W. WIECHERT, ATTORNEY AT LAW**7 **JESSICA C. MUNK, ATTORNEY AT LAW**

8 For Intervenors Thomas Gonzales and Birch Ventures LLC:

9 WOOD LLP

10 333 Sacramento Street

11 San Francisco, California 94111

12 **BY: DASHIELL C. SHAPIRO, ATTORNEY AT LAW**

13

14

15

16

17

18

19

20

21

22

23

24

25

1      Thursday - June 20, 20131      3:32 p.m.2      P R O C E E D I N G S3      ---000---4      **THE CLERK:** Calling case C 04-4264, and all related  
5      matters, Shasta Strategic Investment Fund versus United States  
6      of America.

7      Counsel, please state your appearances.

8      **MR. BAUER:** Good afternoon, Your Honor. Steve Bauer  
9      for the various Strategic Investment Funds.10     **THE COURT:** Good afternoon.11     **MS. MUNK:** And good afternoon, Your Honor. Jessica  
12    Munk and David Wiechert on behalf of intervenors J. Paul Reddam  
13    and Clarence Ventures LLC.14     **THE COURT:** Good afternoon.15     **MR. SHAPIRO:** Your Honor, Dashiell Shapiro on behalf  
16    of Tom Gonzales and Birch Ventures LLC, intervenors.17     **THE COURT:** Good afternoon.18     **MR. WEAVER:** Good afternoon, Your Honor. James  
19    Weaver, Adam Strait, and Adair Boroughs on behalf of the  
20    United States.21     **THE COURT:** Good afternoon.22     This matter is on my calendar for a motion for summary  
23    judgment by the respondent, the Government; and also the  
24    various motions by the intervenors, various groups, with  
25    respect to the procedural question to abbreviated tolling

1 agreements in this matter.

2 As I generally do, let me go ahead and give you my sense  
3 of where I see things having had an opportunity to go through  
4 the voluminous submissions that I did receive, which I  
5 appreciate.

6 As I understand it, this motion pertains, let's talk about  
7 the summary judgment motion first, pertains to the petitions  
8 that were filed by Presidio Growth as the Tax Matters Partner  
9 contesting the FPAAs that were issued to I guess it's around 91  
10 different partnerships, and it arises out of this extremely  
11 convoluted investment strategy known as BLIPS.

12 I have now navigated through the extensive submitted  
13 materials, and I have to say I'm inclined to grant the  
14 Government's motion.

15 I think the undisputed facts do not reflect that these  
16 transactions were foreign currency exchange investments that  
17 were seeking to achieve a profit over their seven-year life;  
18 but instead they were effectively a 60-day strategy that lacked  
19 economic substance, and it was designed artificially to inflate  
20 a participant's tax basis utilizing primarily this premium loan  
21 component but other aspects as well, and the overriding purpose  
22 was to generate tax losses.

23 With respect to the intervenors' motions, they are,  
24 putting them together, directed to, and I realize there are  
25 individual aspects to the various intervenors, but they go to

1 the question of authority to enter into tolling agreements; and  
2 that to the extent that those are not valid, that there is then  
3 statute of limitations issues that arise.

4 To put them together, I have to say I know that the  
5 arguments are various conflict-of-interest problems. I don't  
6 think those win the day. I think the agreements are effective  
7 and valid; and that, therefore, the motions, some of them are  
8 in the form of summary judgment motions, some of them are in  
9 the form of opposition to the Government's motion for summary  
10 judgment, but the intervenors' positions I don't think -- the  
11 various intervenors, my initial read at least is that those  
12 positions are not well taken.

13 So I'll look to the plaintiffs' side and the intervenors'  
14 side to start. Why don't we start with the intervenors'  
15 motions because those are a little clearer.

16 I will tell you also that I have to conclude these  
17 proceedings, because I have a conference call that I have to  
18 participate in, at 4:20. So it cannot go longer than that, and  
19 I hope it will be less than that.

20 So the intervenors' counsel can begin.

21 **MS. MUNK:** Good afternoon, Your Honor. Jessica Munk  
22 on behalf of intervenors J. Paul Reddam and Clarence Ventures  
23 LLC.

24 **THE COURT:** Good afternoon.

25 **MS. MUNK:** I'm going to be addressing the Presidio

1 Growth extensions, the Tax Matter Partner extensions.  
2 Mr. Wiechert is going to address Mr. Reddam's individual  
3 extension. I will be addressing the conflict of interest  
4 argument, as well as Alan Smith's lack of authority to sign for  
5 Foraker and Logan, which is the other intervenor in this case;  
6 and Mr. Shapiro is going to be addressing the remaining issues  
7 regarding the invalidity of the Tax Matter Partner extensions,  
8 and the various briefing he cited on that, and we're joining in  
9 those arguments that Mr. Shapiro filed.

10 First, Your Honor, there are two additional exhibits that  
11 I wanted to admit that I have given to the Government. They're  
12 documents that we received after we filed our reply brief from  
13 the Government on, I believe it was, the end of May. So I have  
14 them labeled as Exhibits 54 and 55. I have given them to the  
15 Government. I don't believe they have an objection, but if I  
16 can hand them up for Your Honor.

17 **THE COURT:** Okay.

18 **MR. WEAVER:** No objection.

19 (Pause in proceedings.)

20 **THE COURT:** Okay.

21 **MS. MUNK:** The statute of limitations for assessments  
22 attributable to partnership items is three years after the  
23 later date from filing of the partnership return or the last  
24 day for filing such a return.

25 Now, Mr. Reddam's partner was Foraker -- BLIPS'

1 partnership was Foraker Strategic Investment Fund. I'll refer  
2 to it as Foraker.

3 Foraker filed its partnership return for the taxable year  
4 1999 on April 13th, 2000. Now, the statute of limitations for  
5 assessments against Foraker expired on April 15th, 2003.

6 Absent a valid extension to the three-year limitations period,  
7 the FPAA issue to Presidio Growth on December 21st, 2004, is  
8 untimely.

9 Now, generally a Tax Matter Partner may enter into an  
10 agreement with the IRS to extend the limitations period and  
11 that extension is binding on all the parties unless the Tax  
12 Matter Partner has a conflict of interest.

13 Now, in 1997, John Larson and Robert Pfaff left KPMG to  
14 form Presidio Advisory Services. They did so in order to  
15 implement KPMG investment strategies that they helped develop.

16 **THE COURT:** Now, Mr. Reddam himself signs the consent;  
17 correct?

18 **MS. MUNK:** He does, Your Honor.

19 **THE COURT:** So that's different than the *Transpac*  
20 case, which is one of the ones that seem to be the principal  
21 case on which you rely.

22 **MS. MUNK:** It is different, Your Honor, but we also  
23 have challenges to Mr. Reddam's -- the validity of Mr. Reddam's  
24 extension, and we believe that extension is also invalid.

25 **THE COURT:** Why?

1                   **MS. MUNK:** Based on the conflict of interest given the  
2 fact that Mr. Hastings, who is a representative of KPMG and  
3 directly involved for implementing, marketing, selling BLIPS to  
4 various people, that he had a conflict of interest. The  
5 Government was criminally investigating KPMG for what they  
6 believed was the largest tax shelter fraud case ever.

7                   **THE COURT:** So everybody is -- these conflicts are  
8 floating out there because Mr. Reddam is, you know, getting  
9 advice and counsel from people that otherwise would have a  
10 reason to be concerned because the Government is investigating.  
11 He has no response -- once -- so, therefore, when he signs, we  
12 just disregard it?

13                   **MS. MUNK:** Well, Your Honor, when he signs, we don't  
14 disregard it, but what we do is we look at who's representing  
15 Mr. Reddam at that point. And I know Mr. Wiechert wanted to  
16 mainly address this argument, but I can touch on it if this  
17 is -- briefly and let him address it some more.

18                   **THE COURT:** Go ahead.

19                   **MS. MUNK:** But KPMG was being investigated by the IRS  
20 and the Federal Government for -- it was basically conducting a  
21 criminal investigation. We know that the Criminal  
22 Investigation Division of the IRS was investigating this case  
23 and made a criminal referral to the Department of Justice.

24                   **THE COURT:** Right.

25                   **MS. MUNK:** They were scrutinizing everything KPMG did,

1 and they believed that KPMG had essentially committed criminal  
2 tax fraud. So the fact that the IRS is accepting waivers or  
3 statute of limitation extensions from the very entity, KPMG,  
4 that they believe has committed fraud, there's clearly a  
5 conflict of interest.

6 And while this is different from *Transpac*, I think the  
7 reasoning in *Transpac* still applies to our case.

8 **THE COURT:** Okay. Go ahead.

9 **MS. MUNK:** Do you want me to -- I can continue on this  
10 point or I can go back to the --

11 **THE COURT:** Go back to your other argument.

12 **MS. MUNK:** Because we recognize that there are the two  
13 extensions that you need to look at. I do believe the  
14 Government wants to only look at the individual taxpayer  
15 extensions and Mr. Reddam's extension; but I think as a  
16 fallback, they do want to look at the Tax Matter Partner  
17 extensions from Presidio Growth.

18 So in 1999, just to give some brief history of this,  
19 Mr. Larson and Mr. Pfaff, along with David Amir Makov --

20 **THE COURT:** I did read the historical information.

21 **MS. MUNK:** Okay.

22 **THE COURT:** So that you need not go over with me  
23 again. I know what happened in terms of the criminal charges  
24 and where that played itself out, Mr. Larson, Mr. Pfaff, and  
25 the like.

1                   **MS. MUNK:** Okay, Your Honor. And I also -- and I  
2 don't know if the Government is challenging this or not,  
3 although they did in their papers, but there was an argument  
4 that they raised that essentially because Mr. Larson didn't  
5 sign for Presidio or Mr. Pfaff didn't sign for Presidio, then  
6 there's no conflict.

7                   We disagree with that, Your Honor. Presidio itself was  
8 being investigated as well because that was the various  
9 entities that Mr. Larson and Mr. Pfaff ended up forming to  
10 implement these various --

11                  **THE COURT:** What's the case authority for the prospect  
12 that because there may have been an investigation going on with  
13 respect to Presidio that, therefore, there's a disabling  
14 conflict for purposes of their signing such that it binds the  
15 partners?

16                  **MS. MUNK:** Well, I think that's the -- I mean, that's  
17 the *Transpac* case, Your Honor.

18                  **THE COURT:** Okay, that's *Transpac* again. Okay.

19                  **MS. MUNK:** I think it's absolutely *Transpac*. Presidio  
20 and KPMG are being investigated by the IRS and they're being  
21 criminally investigated. We know the whistle-blower contacts  
22 the Federal Government in 2002 that summer; and then in around  
23 October 2002, the Senate launches its investigation into these  
24 various what they consider tax shelters.

25                  And it's in March 2003, at that point the IRS realizes

1       they're up against the statute of limitations deadline and it's  
2       about to expire, and they seek statute extensions from Presidio  
3       Growth, the very entity that they're investigating that they  
4       believe has engaged in criminal conduct.

5           And when you look at *Transpac*, that was the issue.  
6       There -- it's very similar. While there might be a few  
7       distinctions, it is very similar because there the IRS started  
8       doing civil audits of the Transpac partnerships. It, just like  
9       here, turned into a criminal investigation; and just like here,  
10      we have several of the Tax Matter Partners who are being  
11      criminally investigated.

12       Well, we know the Tax Matter Partner Presidio was being  
13      investigated and its principals have been convicted. So it's  
14      very similar, Your Honor.

15       And the Government knew that there was a conflict of  
16      interest. And here we believe the Government did know that  
17      there was a conflict of interest. They knew that Presidio and  
18      KPMG had what they believed to have engaged in criminal  
19      conduct, but they still accepted extensions from Presidio  
20      Growth; and we believe that based on this conflict of interest,  
21      it's invalid.

22           **THE COURT:** Okay.

23           **MS. MUNK:** One other point I wanted to highlight is  
24      that in the *Leatherstocking* case, which is also a Second  
25      Circuit opinion, there is some language in there that says that

1 the IRS may have -- I'm sorry, I'm trying to think how it's  
2 worded; but essentially that when the IRS knew the Tax Matter  
3 Partner was defrauding the limited partners, that may be enough  
4 to put the IRS on notice.

5 And I think that language is very persuasive because if  
6 you look here, the IRS had issued numerous summonses to KPMG.  
7 Mr. Larson had responded to numerous summonses. They had tons  
8 of documentation on BLIPS.

9 We know the criminal investigation unit of the IRS is  
10 investigating; and at that point in 2003, which is over a year  
11 after the investigation, they believed that Presidio, the Tax  
12 Matter Partner, was engaged in fraudulent tax shelters. That's  
13 what the IRS believed.

14 So that was enough to put the IRS on notice that when they  
15 get extensions from the Tax Matter Partner, Presidio Growth,  
16 that are going to bind the limited partners, there is a  
17 conflict of interest. And I think *Transpac* and *Leatherstocking*  
18 are directly on point with regards to that, Your Honor.

19 I was also going to address Mr. Smith, Alan Smith is one  
20 that signs on behalf of Presidio, his lack of authority to  
21 sign.

22 **THE COURT:** Okay.

23 **MS. MUNK:** Again, I think in the briefing I go through  
24 pretty clearly the history of who actually is controlling this  
25 company.

1 I believe that the IRS knew that Mr. Larson and Mr. Pfaff  
2 are controlling it; but regardless, when you look at the  
3 documents, Alan Smith essentially appears out of nowhere. I  
4 don't see in the record of the documents we've been given from  
5 the Government that there's actually a document that shows  
6 Odd Eckholt, that was supposedly the director of HSM Growth  
7 Holdings, was actually the director.

8 The documents have Mr. Larson and Mr. Pfaff all over them.  
9 The records of incorporation and the corporate filings have  
10 Mr. Pfaff and Mr. Larson.

11 One of the documents, Exhibit 55 that I handed up,  
12 Your Honor, is a document from I believe it's October 2002, and  
13 it's a document that the IRS had looked at when they were  
14 trying to determine who essentially is in control of these  
15 companies, and it lists Robert Pfaff as the president as late  
16 as 2002; and this is at the same time that the IRS is seeking  
17 to get extensions from Presidio Growth.

18 So based on all of that, I know Mr. Shapiro wants to  
19 address the additional issues and as well he's going to address  
20 the single-member conversion that the Tax Matter Partner  
21 converted to a single member and was no longer the Tax Matter  
22 Partner.

23 **THE COURT:** Okay.

24 **MS. MUNK:** And Mr. Wiechert was also going to address  
25 Mr. Reddam's individual extension, Your Honor. Thank you.

1                   **THE COURT:** All right. Mr. Shapiro, and then we'll  
2 get to the Government.

3                   **MR. WEAVER:** Your Honor, is there any way we can go  
4 issue by issue since --

5                   **THE COURT:** Generally I like to do that, but let's  
6 get -- I would rather have -- it's really a limited amount of  
7 time.

8                   **MR. WEAVER:** Okay.

9                   **THE COURT:** And I want to move it in this fashion so  
10 we can get everybody an opportunity to say what they want to  
11 say.

12                  Go ahead.

13                  **MR. SHAPIRO:** Thank you, Your Honor.

14                  I'll try to briefly identify, I think, the key issues on  
15 the statute, both the factual and legal issues, as to why the  
16 Government should not prevail here.

17                  First is the conversion to single-member LLC. I think  
18 it's clear from the internal documents we've submitted, there's  
19 internal IRS memoranda we cite to in our brief, that the IRS  
20 had identified this as a significant litigating hazard; that if  
21 the TMP converts from a partnership to a single-member LLC, it  
22 terminates the status of the TMP and it can't sign consents on  
23 behalf of the partnership, it can't receive the FPAA notice.  
24 And this is significant because then the statute was never  
25 tolled with the issuance of the notice.

1       The Government tries to make a distinction between a  
2 termination of a partnership and a liquidation or a  
3 dissolution, and that no such distinction can be made. There's  
4 a specific revenue ruling on point, Revenue Ruling 99-6, which  
5 says that when a partnership converts to a single-member LLC,  
6 it's a termination that's also a liquidation.

7       Now, the regulations, the Tax Matter Partner regulations,  
8 under 6231 make it very clear that if the entity liquidates,  
9 that terminates its status as a TMP. It can't act on behalf of  
10 the partnership.

11           **THE COURT:** So nobody could ever sign for that?

12           **MR. SHAPIRO:** No, that's --

13           **THE COURT:** There's no way you can consent?

14           **MR. SHAPIRO:** No, that's not true. There's a  
15 procedure in the 6231 rights for the Government to designate a  
16 new entity as a Tax Matters Partner, and that's what should  
17 have been done here.

18       The Government had actual knowledge that Presidio had  
19 converted to a single-member LLC. There's correspondence that  
20 the Government knew of this from Revenue Agent Diaz that we  
21 cite to in our brief. The Government had actual knowledge of  
22 this; and because they had actual knowledge, I'm going to get  
23 to it in a minute, the actual knowledge of the Government as to  
24 the defects in the TMP status affect the question of whether  
25 the statute was tolled.

1       Moreover, there's a case, *Roundhorse versus Commissioner*,  
2 119 T.C. 157, it's a Tax Court case saying that the IRS can't  
3 litigate contrary positions taken in a revenue ruling. So the  
4 IRS can't stand up and try to argue that this wasn't a  
5 dissolution of the TMP for tax purposes. When a partnership  
6 converts to a single-member LLC, its status is terminated.

7       And this is very significant for tolling because the IRS  
8 cites to the Ninth Circuit case of *O'Neill* saying that, you  
9 know, even if there's a problem -- you know, there the TMP had  
10 filed bankruptcy and then the TMP had filed a petition, and the  
11 petition nevertheless tolled the statute. So the Government is  
12 relying on this to say, "Similarly here, even if there's a  
13 problem with the TMP status, the statute's still tolled."

14       Well, *O'Neill* doesn't apply here because in *O'Neill* the  
15 Court was very clear that the IRS didn't know that the TMP had  
16 filed for bankruptcy.

17       And there's significant authority in the area of tolling  
18 of Tax Court petitions in tax cases where if the Government has  
19 actual knowledge that there's a defect in the petition or in  
20 the validity of the notice, then the statute can't be tolled.

21       One of these cases is *Greve versus Commissioner*. It's --

22       **THE COURT:** Are these cases all set forth in the  
23 briefing that you provided to me?

24       **MR. SHAPIRO:** Well, we just -- *O'Neill* was first  
25 mentioned in the Government's last reply brief, and we haven't

1 had a chance to respond to that. *Greve versus Commissioner*,  
2 42 B.T.A. 142; and Midland Mortgage Company, 576 F.Supp. 101.

3 The Government can't rely on tolling when its own errors  
4 led to the invalid notice and when the statute had already  
5 expired. The statute had already expired as a legal matter  
6 because there were legal defects in the TMP status.

7 And, as a factual matter, we made a number of arguments on  
8 burden of proof, how the burden of proof should be shifted to  
9 the Government. And here there's simply, in terms of looking  
10 at the record on summary judgment as to whether this entity had  
11 authority and whether the individuals that signed on behalf of  
12 the entity had authority, there's simply not a complete record;  
13 and we identified three reasons the burden of proof should  
14 shift, and the Government hasn't responded to any of them.

15 One is Section 7491 requires the burden --

16 **THE COURT:** There really is a limited amount of time.

17 **MR. SHAPIRO:** Okay.

18 **THE COURT:** There's a lot of stuff we have to do, and  
19 I really want to bring to a close the intervenors' motions so I  
20 can get to some discussion on the other issues.

21 So sum up in another minute. I want to hear from the  
22 Government, and then I want to move to the next motion. I'm  
23 sorry, but we just -- time is --

24 **MR. SHAPIRO:** No, I understand.

25 **THE COURT:** -- crunched.

1                   **MR. SHAPIRO:** Okay. And the final point I would make  
2 is that even if you accept -- we have arguments as to the  
3 validity of Mr. Gonzales' consents; but even if you accept the  
4 validity of those consents, the fact that -- the important  
5 point, and we actually wrote an article about this in *Tax Notes*  
6 that came out on Monday that was cited to in our brief  
7 yesterday, even if the individual consent was valid through  
8 2005, when Mr. Gonzales dismissed his Tax Court petition in  
9 2008, the consent, the stipulation he signed did not extend the  
10 statute for partnership items.

11                  And the law is very clear that you have to expressly state  
12 the extension for partnership items. That's why in the  
13 original consents that were signed it states that explicitly  
14 the partnership items were extended.

15                  The IRS failed to include that language in the 2008  
16 extension and, therefore, the statute expired. Even if it --  
17 the statute was survived through 2005, it didn't survive past  
18 2008.

19                  It's 2013 now, and we identified a number of legal and  
20 factual issues in our brief as to why the consents on behalf of  
21 Presidio were not valid, why the consents on behalf of  
22 Mr. Gonzales were not valid. We believe the burden of proof  
23 should shift. We believe there's a lot of issues we identified  
24 that the Government never even responded to: The fact that  
25 there were multiple consents signed, the second consents

1 invalidated the first consent, Odd Eckholt never had proper  
2 authority. There's no evidence in the record.

3 **THE COURT:** Okay. Thank you.

4 **MR. SHAPIRO:** Thank you.

5 **THE COURT:** The Government.

6 **MR. WEAVER:** Thank you, Your Honor.

7 Let me try to address these maybe in reverse order here.

8 First, with respect to the stipulation, the Tax Court  
9 stipulation that Mr. Shapiro is talking about, his reading of  
10 that is just wrong. And if you -- it's Exhibit 10, Docket  
11 64-3. It's very clear that the purpose of that stipulation is  
12 to take care of items that are not in the partnership  
13 proceeding.

14 And I think a fair reading of that is that whatever is in  
15 the partnership proceeding is going to be preserved for the  
16 partnership proceeding, and it's not a consent or an extension  
17 whatsoever.

18 Furthermore, it's our position that once we received a  
19 consent from Mr. Gonzales that took us past the issuance of the  
20 FPAA and there was a timely petition filed by Presidio Growth,  
21 that's all we need. So that's all I have to say about the  
22 stipulation.

23 More broadly, our logic is as follows:

24 If the FPAA notices were valid, and we believe they are,  
25 and I want to speak to that briefly, and we have individual

1 consents for both Mr. Reddam and for Mr. Gonzales, that's it.

2           **THE COURT:** How about the conflict issues? I mean,  
3 their principal argument is, okay, you've got individual  
4 consents and that perhaps in one sense takes you out from under  
5 the *Transpac*, some of *Transpac*; but they're saying that it  
6 doesn't mean much because of the various conflicts that they  
7 identified by virtue of the criminal investigation.

8           **MR. WEAVER:** Well, Reddam's position is slightly  
9 different than Gonzales'.

10           **THE COURT:** Right.

11           **MR. WEAVER:** Gonzales' is simpler so let me take that  
12 first. Gonzales, I think it's fair to characterize this, if  
13 their individual consents are good, they're done.

14           They do not allege that Mr. Gonzales was somehow  
15 conflicted himself out when he signed. They're arguing that  
16 the consents we received from the Tax Matters Partners are  
17 invalid; but the law under the Tax Code is if you get a consent  
18 from the individual partner, you're done as to that partner.

19           We got consents from Mr. Gonzales.

20           **THE COURT:** Even if that partner has been receiving  
21 advice and counsel from advisers who are, according to their  
22 argument, motivated to curry favor with the Government?

23           **MR. WEAVER:** Well, Gonzales did not brief that. He  
24 may have adopted the Reddam brief, but there's nothing in the  
25 record to show that Gonzales was unduly influenced somehow.

1 You know, who was influencing him? Because as far as we know,  
2 he wasn't talking to Mr. Larson or Mr. Pfaff.

3 **THE COURT:** Okay. Let's talk about Reddam now.

4 **MR. WEAVER:** Okay. With respect to Reddam, I will  
5 just refer you, with respect to the conflict of interest, to  
6 two documents. One Ms. Munk filed. It's Docket Number 130-2  
7 in the '63 case. It's her Exhibit 53, and it's a conflict of  
8 interest waiver with respect to the person she alleges had a  
9 conflict that was advising Mr. Reddam to sign his individual  
10 consents. That person is Mr. Hasting of KPMG.

11 **THE COURT:** Right.

12 **MR. WEAVER:** All I want to say about that is, there it  
13 is. The conflict is identified and, lo and behold, he signs  
14 anyways. What more can you ask? I mean, we've briefed this.

15 The other thing to say about the conflict of interest  
16 argument in general, staying with that for a second, is it's  
17 not enough to allege or suspect or speculate about conflict.  
18 That's the Ninth Circuit case of *Phillips*. You have to show an  
19 actual conflict.

20 They're the moving party. They have the burden of proof.  
21 They haven't met that burden of proof. And, moreover, here  
22 there's a fundamental difference between their position, their  
23 litigating position here, and *Transpac*; and that is, they  
24 wanted to sign consents. They signed consents.

25 In *Transpac* the real problem the Second Circuit had was

1 that the IRS went to the individual partners and they refused;  
2 and then, only and then, did they go to the Tax Matters Partner  
3 who was cooperating.

4 So that's just not the case here, and that's all I have to  
5 say about that.

6 **THE COURT:** Okay. Yes?

7 **MR. WEAVER:** I have -- quickly if I can, Your Honor,  
8 the other thing I would just add is the other hook that we have  
9 to cross to get where we need to be is the validity of the  
10 FPAA, and Mr. Shapiro raises that in the Gonzales brief,  
11 Mr. Wood does.

12 And I would refer you to three Ninth Circuit cases.

13 *Stone* -- well, let me rephrase that, that were affirmed by the  
14 Ninth Circuit: *Stone Canyon Partners v. Commissioner*, *Seneca*  
15 and *Anderson*. All of those cases, plus a couple others, the  
16 *Chomp* case in particular, are directly contrary to  
17 Mr. Gonzales' position here.

18 And the idea is, we sent out not only FPAAAs, the notices,  
19 to everybody in the world, which should be enough, we sent it  
20 out generically to a Tax Matters Partner care of the address;  
21 and the case law says, if you do that, that's fine. As a  
22 matter of fact, the *Chomp* case says this is a valid mechanism  
23 for doing this. It's in the regulation, and it's especially  
24 apt in confused circumstances.

25 And if you read the papers, I was thrilled that

1 Mr. Shapiro wanted to submit this stuff in camera yesterday  
2 because it lays out perhaps better than I can the legal  
3 analysis that the IRS had to go through.

4 I mean, the IRS was between a rock and a hard place. On  
5 the one hand, maybe Presidio Growth was still a Tax Matters  
6 Partner. He's wrong about his legal analysis on whether  
7 there's a difference between state law and tax dissolution. In  
8 fact, there's a revenue ruling, I think it's notice -- we cite  
9 to it in our papers. I think it's 2480 or something like that,  
10 2488, where the IRS has specifically indicated a single-member  
11 LLC can be a Tax Matters Partner.

12 So on the one hand we have information. The IRS was  
13 clearing mulling this over. On the other hand, if they just  
14 went out, as Mr. Shapiro suggested we do, and appoint another  
15 Tax Matters Partner, you know what? They'd be right back in  
16 here saying, "Oh, you did it wrong. You should have stayed  
17 with Presidio Growth."

18 We did our best. We sent notices out to everyone and we  
19 complied with the statute.

20 **THE COURT:** All right. I want to move on to the  
21 substantive motion.

22 So who wants to speak on the motion for summary judgment?

23 **MR. BAUER:** Your Honor, if your hard stop is 45  
24 seconds ago, I would be very willing to come back tomorrow  
25 morning for 15 minutes to be able to say my piece.

1                   **THE COURT:** I've got lots to do tomorrow morning.

2 This is your moment. Go for it.

3                   **MR. BAUER:** Okay. My shining moment.

4                   Well, I will agree with you that these are convoluted  
5 investments, but they're actually quite interesting when you  
6 get in them; and I think my summary statement is for you to  
7 make a judgment of whether these will work or whether they  
8 don't under the theories that the Government's presented.

9 You're absolutely making decisions of fact because there are  
10 fact issues here. You can't possibly --

11                   **THE COURT:** Summarize the fact issues for me.

12                   **MR. BAUER:** There are challenges on the economic  
13 substance doctrine.

14                   **THE COURT:** Right.

15                   **MR. BAUER:** Two prongs in the Ninth Circuit, one  
16 objective, one subjective.

17                   **THE COURT:** Right.

18                   **MR. BAUER:** The objective one, the case they cite says  
19 no practical economic effects; right? And, so, that's a fact  
20 question.

21                   Could someone make money if the Argentine peso devalued?  
22 Yes, in fact, it did devalue a year later.

23                   **THE COURT:** I don't think the standard is could  
24 conceivably some money be made during the 60-day window; and I  
25 think it's pretty compelling that out of, I forget how many

1 investors are involved, two of them stay on more than 60 days.

2 And with Mr. Rifkin's testimony and the other testimony in  
3 the record, I don't think there is a dispute that the investors  
4 go in and out in 60 days. And the idea that the peg is going  
5 to be broken in 60 days, there's evidence that says it is  
6 almost infinitesimal that that would occur.

7 And the standard is not conceivably could money be made.  
8 It's -- I forget the language, but there's case law that says  
9 it has to -- there has to be substantive economic benefit that  
10 is being sought from this, and the undisputed facts here show  
11 this was designed to generate tax losses.

12 Go ahead. Sorry to take part of your time, but go ahead,  
13 Mr. Bauer.

14 **MR. BAUER:** High-risk, high-return investment. That's  
15 what the Larson declaration says. That's what the Pfaff  
16 declaration says. That's what Makov's long deposition said,  
17 which is the only testimony from him that's admissible in this  
18 case.

19 So absolutely high risk, but potentially very high  
20 returns. It could happen in 60 days. It could happen in a  
21 year. It could happen in two days.

22 One of the key evidence, pieces of evidence, that shows  
23 that that's a fact is it is undisputed here, conceded by them,  
24 that the banks hedged this investment. They didn't want to  
25 have a risk that the peg could break and they could lose all

1 their money, so the banks spent money hedging the investment.

2 Are there practical economic effects? Certainly. This is  
3 not a made-up investment. It is an investment that is  
4 admittedly high risk, high return, but you would have to be  
5 making some factual finding that somehow that this is not a  
6 high-risk, high-return investment.

7 **THE COURT:** No. I'd be taking into account the  
8 standard. The standard is, where perhaps you and I part  
9 company, is what I'm hearing you saying is, if there's any  
10 conceivable way money could be made out of this investment,  
11 then, therefore, summary judgment should be denied.

12 And I think the standard is -- the undisputed fact  
13 analysis goes to whether or not when the facts of this  
14 investment reflect whether or not it has substantial economic  
15 aspect to it, and I don't think there are any undisputed facts  
16 that indicate it was anything but a loss-generating enterprise.

17 **MR. BAUER:** And what you've done there, right, is  
18 you've moved into the subjective prong of it; and the  
19 subjective prong is: Did investors, did the people in charge  
20 of the partnerships believe they could make money on it? And  
21 you have in the record, you know, as a factual statement; and  
22 these guys will come in here and testify: Larson, Pfaff, and  
23 the Makov deposition and Mr. Reddam's declaration.

24 If you're making that decision, you're saying, "I don't  
25 believe their testimony," and you haven't seen it; and you

1 would be doing it on the basis of declarations from people  
2 that you haven't seen that are also contradicted by all the  
3 evidence of what they used to say before the Government got  
4 cooperation agreements out of them.

5 Part one is objective and the test is not was their  
6 substantial. You can have -- think of all these venture  
7 capital investors. They're going on 2 percent chances, but  
8 there's a huge venture capital industry. Think of all the  
9 low-risk -- I mean, high-risk, high-return investments that  
10 people with a lot of money would make. This isn't an  
11 investment that you or I would make. This is something --  
12 these are ones that people looked at that and said, "My  
13 goodness, I can get in and have a 40-million-dollar short on  
14 the Argentine peso, and" --

15 **THE COURT:** Within 60 days?

16 **MR. BAUER:** Within 60 days.

17 **THE COURT:** Where's the evidence that there is any  
18 realistic prospect within that 60-day window? And I think it's  
19 undisputed effectively that it's an in and out in 60 days.

20 **MR. BAUER:** Well, the --

21 **THE COURT:** And, so, if it's in and out within 60  
22 days, where is there any evidence that this is realistically  
23 the breaking out of the currency pays? Even your own people  
24 are saying there's no real prospect for that.

25 **MR. BAUER:** I disagree, Your Honor. And the test

1 isn't realistic by whose standard. What are the chances? All  
2 right. What are the chances? Nobody knows. You can't predict  
3 when the lightbulb's going to burn out exactly. You know it's  
4 going to burn out, but you can't predict when.

5 We know these are valid investments because people make  
6 them all the time. Everyone is shorting and going long  
7 currencies all the time; and if the Court's logic were  
8 accurate --

9 **THE COURT:** Yeah, but they don't have all these other  
10 built-in component parts to this transaction which, as you look  
11 at them, are designed for purposes of inflating the basis for  
12 purposes of generating losses.

13 **MR. BAUER:** No one is denying that this was a  
14 tax-based investment. No one is denying that. All these  
15 people went in there having made gains and wanting to have this  
16 possibility of getting this tax benefit. So no one's denying  
17 that at all. I mean, KPMG and Brown & Wood wrote the opinions.

18 Of course it's tax based, but the test isn't a realistic  
19 possibility based on, you know, your economics or my economics.  
20 It's what an investor actually thought, and did the investor  
21 believe that this was a good investment for them, did he think  
22 he could make money. Were there practical economic effects?  
23 Certainly, people made and lost money on those pegs -- on those  
24 investments when they happened.

25 I understand what you're saying, and I understand that in

1 a bench trial I'm going to be swimming upstream; but without  
2 actually seeing the evidence and hearing the people testify,  
3 with all due respect, I think you're making fact and  
4 credibility judgments about the Larson declaration, the Pfaff  
5 declaration, the Makov deposition testimony, which even in  
6 advance of a bench trial is not appropriate at the summary  
7 judgment level.

8 I think that when you see the testimony and hear what  
9 these people have to say, I might be able to change your mind.

10 **THE COURT:** Okay. Thank you.

11 The Government?

12 **MR. WEAVER:** Yes, Your Honor.

13 Let me briefly address why this case is, in fact,  
14 appropriate to dispose of on summary judgment, and I want to  
15 start out with the legal standard which Mr. Bauer did not get  
16 correct.

17 He did cite the sham test is whether a transaction had any  
18 practical economic effects on the creation of income tax  
19 losses, and there is a subjective and an objective side. But  
20 the fact of the matter is, and the standard is not contradicted  
21 in the *Casebeer* case, which is the leading Ninth Circuit case,  
22 the lack of economic substance alone suffices to invalidate a  
23 transaction even if there's some subjective belief,  
24 unreasonable belief, on the part of a taxpayer that there might  
25 be some profit potential there.

1       What's the authority for that? Well, the authority is the  
2 Fifth Circuit case of *Klamath* which cites to the Federal  
3 Circuit, which is the *Coltec* case, the *Coltec* at the Federal  
4 Circuit level; the Third Circuit; the Tenth Circuit.

5       And then there's this, and I think this seals the deal,  
6 and that is Footnote 8 out of *Casebeer* is addressing an  
7 argument similar to the one Mr. Bauer just made about  
8 subjective intent. Quote: (reading)

9               "The presence of a business purpose does not entitle  
10              a transaction to be recognized for federal tax purposes  
11              where objective indicia of economic substance indicating a  
12              realistic potential for economic profit are not manifest."

13           Then it says: (reading)

14               "Although this statement conflicts with prior Tax  
15              Court authority," citing to what became a Fourth Circuit  
16              case, *Rice World*, here's the kicker, quote, "it is not  
17              inconsistent with our flexible application of the  
18              two-prong test."

19       Now, Your Honor, we cited to the Scott --

20           **THE COURT:** Was that on summary judgment?

21           **MR. WEAVER:** I believe that was a trial, Your Honor,  
22 but --

23           **THE COURT:** All right. That's of some consequence;  
24 isn't it?

25           **MR. WEAVER:** Well, no. The idea, Your Honor, is that

1 if this transaction is so far afield, you do not have to  
2 take -- if there is -- if you can decide beyond any reasonable  
3 dispute that this transaction lacked substance, you can stop  
4 right there.

5 And given that circumstance, what's in evidence? Well,  
6 there is a very general declaration from Mr. Larson and  
7 Mr. Pfaff; and, you know, they talk about "I believed," "I  
8 understood," but there's no objective analysis.

9 One of the reasons that this case is ripe for summary  
10 judgment, there's only one objective expert that's going to  
11 even appear at trial. Now, that's Dr. DeRosa.

12 **THE COURT:** Your expert.

13 **MR. WEAVER:** Our expert, the only one.

14 But there's another reason, and that is, what's the  
15 transaction that matters? And there's plenty of case authority  
16 for this, both the *Coltec* case; there's a Third Circuit case,  
17 *ACM; Sala*, a Tenth Circuit case. We cited to these. And that  
18 is, the transaction that matters is the one that creates the  
19 tax benefit.

20 So the undisputed testimony is that, you know, the tax  
21 benefit was created by a premium loan; and the record is devoid  
22 of any contrary evidence that that premium loan, the high  
23 front-loaded interest that was supposed to be of such great  
24 convexity benefit or front loading it, that got wiped out.  
25 That got wiped out, Your Honor, by the simultaneous execution

1 of a swap arrangement.

2 Now, that's addressed in DeRosa's opinion. If I had more  
3 time, I had some charts I wanted to take you through, but let  
4 me refer you to two additional exhibits in addition to the ones  
5 that I talked about in our papers that I think are just  
6 incredibly compelling.

7 One is our Exhibit 812. It's a spreadsheet which Presidio  
8 produced to the Government, so it's an internal Presidio  
9 document, that shows how the transaction in the Shasta case was  
10 unwound.

11 And keep in mind, Larson and Pfaff have declared that all  
12 these transactions are basically the same thing.

13 Exhibit 812, Your Honor, if you take the loan premium  
14 amount that was originally advanced in Shasta, \$35.5 million,  
15 and then you look over how they unwind the transaction, there's  
16 a prepayment penalty under the premium loan. You add up the  
17 prepayment penalty and the swap termination fee, boom, you have  
18 \$35 million.

19 They repay the principal dollar for dollar. What interest  
20 do they end up paying? The swap interest rate. That's a  
21 low-interest rate. It's a market interest rate. There's no  
22 convexity associated with a market interest rate because the  
23 price doesn't change on a bond that has a floating interest  
24 rate when interest rates change.

25 And, so, Your Honor, looking at the other exhibit,

1 Exhibit 835, that's their Form 1065 tax return, what did they  
2 report? These wonderful high-interest rate benefits of this  
3 premium loan, is that what they reported on their tax return?  
4 Absolutely not.

5 Because if you look at the unwind sheet, the premium  
6 interest is over \$2 million. They report as investment  
7 interest expense something on the order of 1.2 million. And  
8 what is that? It's precisely two things; and we know this  
9 because, thanks to Mr. Bauer, I didn't submit this, he  
10 submitted a work sheet, I think it's Exhibit T, and you can  
11 trace through to the amount on the partnership K-1s by adding  
12 two things: The additional margin amount, which is listed  
13 there, to the swap interest.

14 Those two things will add up in the Shasta case to  
15 1.2 million. They'll add up to whatever they did in Belford;  
16 but the idea, Your Honor, is that exactly precisely what is  
17 this in economic reality? It's a floating-rate note for the  
18 full amount of the funding amount, and that doesn't provide any  
19 economic benefit that the plaintiffs claim it does.

20 Finally, let me just also --

21 **THE COURT:** Well, but doesn't -- I mean, Mr. Bauer's  
22 point seems to be that even granting all of those benefits in  
23 terms of tax benefits that these investors are going to get,  
24 they have the upside potential of some benefit, albeit a very  
25 risky and perhaps unlikely event, that there's going to be this

1 breakout of the currency peg and the Argentine peso is going to  
2 go crazy and they're going to benefit.

3 **MR. WEAVER:** That had nothing to do with the loan  
4 transaction. The loan proceeds were invested in Eurodollar  
5 rolls that DeRosa explains are nothing more than U.S. time  
6 deposits. In fact, it's just incorrectly stated in  
7 petitioner's brief.

8 **THE COURT:** There was some currency trading that  
9 actually did occur, the minimal.

10 **MR. WEAVER:** The minimal currency trading -- these  
11 forward contracts in the Argentine peso and Hong Kong dollar  
12 had zero value at the outset. They only have value if  
13 something goes awry and the peg breaks.

14 And the testimony of the only objective person in the  
15 case, DeRosa, who advanced an objective opinion and analysis,  
16 is that those were supported by the small amount that the  
17 taxpayer put in.

18 All of the loan funds, they were rolled over for amount of  
19 interest that was less than they were paying on the loan. It  
20 was a guaranteed money loser with the loan funds, and that was  
21 intentional because then you can squeeze out an investor that  
22 stayed in too long and didn't just take the tax benefits.

23 And with respect to the currency forwards having been  
24 funded by those small taxpayer margin, having nothing to do  
25 with the transaction that matters here, which is the loan

1 transaction, we also submitted some declarations. We have a  
2 declaration from the HVB banker Domenick DeGiorgio who says  
3 that the loan had nothing to do with the Hong Kong dollar  
4 trades that had this remote possibility of earning a profit.

5 Likewise, we submitted the equivalent of essentially a  
6 30(b) (6) declaration from Deutsche Bank and I believe also from  
7 HVB Bank. They basically say the same thing.

8 So, Your Honor, the short of it is, it's the loan  
9 transaction that mattered. That's the way that the *Klamath*  
10 case was analyzed. We don't agree with everything in the  
11 *Klamath* case but Judge Ward in the *Klamath* case looked to the  
12 loan transaction.

13 Now, I haven't really had an opportunity to address, and I  
14 know I'm running up against your deadline, Your Honor, but, in  
15 addition, if you actually look at the loan agreements and  
16 start, you know, going through the terms, the loan collateral  
17 was locked up. You had to actually have 101 and a quarter  
18 percent on collateral with the bank.

19 **THE COURT:** Calm down, Mr. Bauer. You don't -- you  
20 know, it's not appropriate to go through histrionics when --

21 **MR. BAUER:** I'm sorry, Your Honor. It's outrageous.

22 **THE COURT:** -- your counterpart is making arguments.  
23 I know you think it's outrageous, but calm down.

24 **MR. BAUER:** Okay.

25 **THE COURT:** Go ahead.

1                   **MR. WEAVER:** And if you look at the terms of the loan,  
2 it's not just 101 and a quarter percent, because there is a way  
3 that they have to value the collateral. It takes it up,  
4 according to DeRosa, to something like 101.6 percent.

5                   So there is just no way, if anything started going bad,  
6 these trades would have been closed down by the bank and that  
7 would have been it.

8                   These were tax-motivated deals. There was no reasonable  
9 chance of making a profit.

10                  And with respect to the penalties, because I don't want to  
11 forget about the penalties, I need to tell you two things.  
12 First, petitioner's have briefed the penalties. We've briefed  
13 the penalties. We didn't really do them justice. The issue  
14 about subject matter jurisdiction on penalties and the  
15 40 percent are on appeal to the Supreme Court. It's the  
16 *Woods/Tesoro* case. So that remains on appeal.

17                  But what do we have here? We have a situation,  
18 Your Honor, where Mr. Makov, Mr. Larson, and Mr. Pfaff  
19 certainly had to know at a minimum that this was a negligent  
20 tax shelter as structured because they, in fact, admitted it.

21                  In fact, one of the things we put into evidence was the  
22 Rifkin declaration; and you can tell from the Rifkin  
23 declaration that there was a Dallas meeting, and in that  
24 meeting Makov actually says that there was only a very remote  
25 chance for profit.

1                   **THE COURT:** I'm anticipating what your counterparts  
2 will argue. Aren't you now selecting out certain aspects of  
3 declarations and ignoring others? In other words, isn't that,  
4 as according to their argument, the factual dispute that we're  
5 going to get to because people like Pfaff and Larson are  
6 providing at various other points along the path declarations  
7 or statements that reflect a different view?

8                   **MR. WEAVER:** There is nothing in the record that  
9 specifically counteracts the reality that the swap canceled out  
10 the loan agreement, and there is -- that's as far as you really  
11 need to go.

12                  But let me close by referring you to the *Scott v. Harris*  
13 case; and although I can't be as exciting as that case, that's  
14 the case where there are two wildly different versions of what  
15 happened in a high-speed car chase between the police and a  
16 driver, and I think the driver ended up being a quadriplegic  
17 and sued.

18                  And, you know, I think it went up through the Eleventh  
19 Circuit, and the nonmoving party was the driver who had been  
20 rammed by a police car. And, so, the Eleventh Circuit says,  
21 "We can't resolve this on summary judgment. There are two very  
22 differing versions." And the Supreme Court said, "Yeah, but  
23 for one thing, there's a videotape."

24                  **THE COURT:** I know, that's a very controversial  
25 decision and that one -- yes, the Supreme Court did look at

1 that videotape. Now, whether or not that's consistent with  
2 other Supreme Court decisions as to whether or not the  
3 Appellate Court should be looking at that kind of evidence is a  
4 different proposition. But, okay, I hear you. I understand.

5 **MR. WEAVER:** And, so, if you look at that unwind sheet  
6 as I told you, when you look at the documents, you don't even  
7 need the testimony. It was guaranteed that this was a  
8 floating-rate note that didn't provide any real tax benefits.  
9 Economically that's all this transaction was at best.

10 **THE COURT:** All right. Mr. Bauer?

11 **MR. BAUER:** Okay. I apologize again, Your Honor. I'm  
12 sorry. I think it's the time pressure of having on a summary  
13 judgment --

14 **THE COURT:** You're a fine advocate who's an advocate,  
15 and I understand that.

16 **MR. BAUER:** Okay. But I do apologize sincerely.  
17 But he stood up and made about 10 really fast factual  
18 arguments to you, and just illustrating why this is a trial and  
19 not a summary judgment case.

20 For example, he's talking about Mr. DeRosa and whether the  
21 loan is ever used in these investments. Well, in their own  
22 brief on page 35, the Government says, "Yes, the loan is used  
23 as collateral."

24 When I take Mr. -- what's his name? -- DeRosa's deposition  
25 and say, "So you say that the loans weren't used as collateral,

1 how could that be?"

2 My clients swear that they are, swear they believe they  
3 are. Makov testifies in a deposition with great detail, you  
4 know, with supporting documents how it was used.

5 And what does DeRosa say? He said, "Well, somebody once  
6 called me and told me I didn't have to do that."

7 I said, "You're kidding me? You're the big expert for the  
8 United States Government, a key point in the case and who  
9 called you? What did they say?"

10 "Oh, it's, like, a guy called me."

11 And you're saying that's an undisputed fact? I mean, it's  
12 laughable on its face.

13 The idea that the swap negates the loan, that's just  
14 factually wrong. It's not like a mortgage where you refinance  
15 a mortgage and then the loan is gone. A swap is a hedge. So  
16 if I'm long, if I'm long on a stock and then I short the stock  
17 too, it doesn't mean I don't own the stock. It means I'm long  
18 and I'm short. I have two different contracts, and there are  
19 tax consequences to both.

20 So to say that -- I mean, that's just factually wrong, and  
21 there's no person who can declare that to be truthful; and our  
22 testimony will be, no, that's not truthful.

23 You know, just one after the next, after the next, these  
24 are all fact issues.

25 Your Honor, I don't know, apparently our briefs maybe

1 didn't make it clear enough when you say that the actual  
2 currency forwards were negligible. They weren't. This was  
3 big-time money. This was probably -- the hypothetical that  
4 they always used would be a hundred-million-dollar loan. It  
5 would have a 60-million-dollar premium and \$60 million would be  
6 the notional value of these currency forwards.

7 So if, like as we've shown, all these different currencies  
8 that broke during the 1990s, if the Argentine peso had broken  
9 during that time and, you know, it devalued, it devalued  
10 70 percent, a person that has a 60-million-dollar investment  
11 there would make \$42 million.

12 I mean, this was big time. You know, KPMG, Brown & Wood,  
13 fancy investors. There's a lot of money involved in it. None  
14 of these investments were negligible.

15 One of these key points of the investment, as folks will  
16 testify, was that the investment was nonrecourse. So investors  
17 could go in there, get access to these very big currency plays  
18 without putting their other, you know, fortunes at risk; and  
19 then they had a possibility that, because of the use of the  
20 loan, they would get a tax benefit. They knew it wasn't for  
21 sure, but they knew -- they thought that someday they'd get a  
22 day in court to say whether -- you know, to analyze the tax  
23 aspects of this.

24 **THE COURT:** It's not a possibility of tax benefit.  
25 That, they were somewhat assured of; wasn't it? It was

1 possibility of upside profit.

2           **MR. BAUER:** No, no, no. The opinion letters and the  
3 way all this IRS stuff works is the opinion said, "It's more  
4 likely than not you're going to get your tax benefit." Nobody  
5 promised everybody they would get the tax benefit.

6           When I first got into this, Your Honor, there's all these  
7 different levels of legal opinion that you can get under the  
8 IRS Code, and this one is more likely than not; meaning you'll  
9 get your day in court and someday Judge Seeborg will say  
10 whether you get that or not.

11           My last point, and this was in the brief, you know, there  
12 is no loan that is morally superior to any other loan. And  
13 while he says, "Oh, a premium loan, how could this -- this is  
14 some weird loan," it's not. There's sections in the IRS Code  
15 going back to, I think, the '30s talking about tax treatments  
16 of premium bonds, which is what a premium loan is.

17           So a mortgage is like the ultimate premium loan because at  
18 the end of your payment period, you don't owe anything. You  
19 know, a bond you borrow money, you pay interest, and then you  
20 have to pay the principal back at the end, but there's no  
21 reason it has to be that way. There's negative amortization  
22 loans in which you owe more at the end. There's ones where you  
23 pay -- Makov talked about in his deposition and showed that  
24 there are many instances where people borrow a premium. For  
25 some reason a lot of municipalities borrow using premium loans

1 because they're trying to adjust their cash flow in some way.

2 So just to say, "Ah, this is some crazy loan so that, you  
3 know, you should throw out the transaction because of that," I  
4 mean, that's just factually wrong.

5 **THE COURT:** I don't hear the Government arguing that  
6 because there is a premium loan here that it's, by definition,  
7 some sort of sham. I hear them saying that you look at this  
8 entire -- you have to step back and look at the whole  
9 transaction and you have to look at the premium loan component  
10 in terms of how it works in this investment, not that there's  
11 something nefarious in and of itself in a premium loan  
12 structure.

13 So I didn't hear them say, "Oh, you know, just look. You  
14 see that there's a premium loan component to this and,  
15 therefore, it's a tax shelter that is designed purely to obtain  
16 tax losses."

17 They're saying, "Look at this whole transaction. Look at  
18 the 60, 120, 7-year life, various other components of this.  
19 Step back and look at it all and see what it's designed to do."

20 **MR. BAUER:** I hear what you're saying. That's the  
21 broadest economic substance point, which is, can you make money  
22 on this overall scheme if the peg breaks, can you make money.  
23 We sort of talked about that.

24 The loan argument that they make is a little bit  
25 different. The loan argument, as I understand it, is that, you

1 know, we say and they now say that the loan is necessary  
2 because it serves as collateral for the investments. Okay. So  
3 it's used in the investment program in that way, and that's  
4 what the KPMG opinion said also.

5 What I hear them to say is that the premium loan doesn't  
6 make a difference. They say the premium doesn't help you, and  
7 I understand that argument to be, "Look, you could have used  
8 some other kind of loan and you wouldn't have gotten these  
9 possible tax benefits."

10 And my argument is: No loan is morally superior to any  
11 other kind of loan. Of course, they chose the premium loan  
12 because of the premium bond and liability sections under the  
13 IRS -- in the IRS Code. So they were trying to get a tax  
14 benefit by doing a particular kind of loan, and there's nothing  
15 that prevents anybody from doing that.

16 So that -- I think I -- if you understand that argument,  
17 Your Honor, it shows that a loan is necessary. It doesn't  
18 matter what kind of loan, and any taxpayer can choose the kind  
19 of loan that is most advantageous. If I want to borrow money,  
20 I can do it through a mortgage. I can do it through a line of  
21 credit. Some might be deductible, it might not. I can choose  
22 the way I'd like to borrow the money in order to get a tax  
23 benefit. It doesn't make it suspect.

24 **THE COURT:** Okay.

25 **MR. BAUER:** Okay.

**MR. WEAVER:** Your Honor, can I just, two minutes?

**THE COURT:** I have to go. I'm expected on a  
ce call and you've extensively briefed this, and I have  
f material with which to go back and examine it and  
rough it and make a decision. So thank you, but we're

(Proceedings adjourned at 4:28 p.m.)

-----o0o-----

**CERTIFICATE OF REPORTER**

I certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

DATE: Monday, July 8, 2013

Jo Ann Bryce, CSR No. 3321, RMR, CRR, FCRR  
U.S. Court Reporter

25